

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 AID-05 CEA-01 CIAE-00 COME-00 EB-07

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INFO AMEMBASSY BERN

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PASS CEA, TREASURY, FRB

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TAGS: ECON, OECD

SUBJECT: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE (EDRC)
REVIEW OF SWITZERLAND, FEBRUARY 5

REFS: (A) OECD DOCUMENT EDR(76)2, (B) BERN 447

1. SUMMARY: IN REFDOC CIRCULATED FOR FEBRUARY 5 EDRC
REVIEW OF SWITZERLAND, SECRETARIAT ESTIMATES THAT SWISS
REAL GNP FELL BY 4 PERCENT IN 1975, AND FORECASTS GNP
GROWTH OF ONLY 1 PERCENT IN 1976 WITH RECOVERY BEGINNING
IN SECOND HALF OF YEAR. GNP DECLINE IN 1975 LARGELY
RESULT OF STEEP FALL IN FIXED INVESTMENT (ESPECIALLY
CONSTRUCTION), WHILE INCREASED GOVERNMENT CONSUMPTION
AND STRONG REAL FOREIGN BALANCE WERE MAJOR ELEMENTS OF
SUPPORT. SECRETARIAT FORECASTS 2 PERCENT INCREASE IN
EXPORT AND IMPORT VOLUMES IN 1976, SOME DETERIORATION
IN TERMS OF TRADE AND NARROWING OF CURRENT ACCOUNT
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SURPLUS TO \$1.9 BILLION FROM \$2.5 BILLION ESTIMATED FOR

1975. SECRETARIAT NOTES THAT CONTINUING LARGE SURPLUS COULD EXERT FURTHER UPWARD PRESSURE ON SWISS FRANC DURING 1976. CURRENT ACCOUNT SURPLUS, WEAK GROWTH OUTLOOK AND FAVORABLE INFLATION FORECAST (4 PERCENT IN 1976) LEAD SECRETARIAT TO RECOMMEND CONTINUATION OF PRESENT EXPANSIONARY MONETARY AND FISCAL POLICIES, BUT IT NOTES THAT PACE OF SWISS RECOVERY PRIMARILY DEPENDENT ON GROWTH OF WORLD TRADE. ACTION REQUESTED: COMMENTS/QUESTIONS WHICH COULD BE USEFULLY POSED DURING REVIEW. FOR BERN: MISSION WELCOMES PARTICIPATION IN REVIEW OF ECONOMIC OFFICER SPILLANE OF EMBASSY BERN; PER REQUEST REF B, SINGLE WITH BATH RESERVED FOR SPILLANE AT HOTEL FREMIET (6 AVENUE FREMIET) FOR NIGHTS OF FEB 4 AND 5. MISSION CONTACT IS PAUL M. MCGONAGLE, ECONOMIC POLICY ADVISOR, TEL 524-9763.

2. SHORT-TERM PROSPECTS; DOMESTIC OUTLOOK: SECRETARIAT ESTIMATES THAT SWISS REAL GNP FELL BY 4 PERCENT IN 1975, WITH MAJOR CONTRIBUTORY FACTOR BEING 20 PERCENT DROP IN FIXED INVESTMENT (CONSTRUCTION INVESTMENT FELL BY 25 PERCENT). DESTOCKING AND DECLINE IN PRIVATE CONSUMPTION (2.8 PERCENT) ALSO CONTRIBUTED TO FALL, WHILE 5 PERCENT INCREASE IN PUBLIC CONSUMPTION AND 2.9 PERCENT IMPROVEMENT IN REAL FOREIGN BALANCE PROVIDED SUPPORT. FOR 1976, SECRETARIAT EXPECTS NO INCREASE IN PRIVATE CONSUMPTION, 2.5 PERCENT FALL IN FIXED INVESTMENT, 7 PERCENT INCREASE IN PUBLIC CONSUMPTION, NO CHANGE IN REAL FOREIGN BALANCE AND ONLY 1 PERCENT GROWTH IN REAL GNP. IN VIEW OF SUBSTANTIAL SLACK IMPLIED BY GROWTH SCENARIO, SECRETARIAT FORECASTS DECELERATION OF CONSUMER PRICES TO 4 PERCENT IN 1976 FROM 6.7 PERCENT IN 1975, BUT CONTINUING RISE IN UNEMPLOYMENT.

3. CURRENT ACCOUNT: IN 1975, SECRETARIAT ESTIMATES THAT 11 PERCENT FALL IN EXPORT VOLUMES WAS MORE THAN OFFSET BY EFFECT OF 6.4 PERCENT DECLINE IN FINAL DOMESTIC DEMAND AND DESTOCKING ON IMPORT VOLUMES, WHICH DROPPED BY 18 PERCENT. CURRENT ACCOUNT SURPLUS IN 1975 ESTIMATED AT \$2.5 BILLION. FOR 1976, SECRETARIAT FORECASTS 2 PERCENT INCREASE IN BOTH IMPORT AND EXPORT LIMITED OFFICIAL USE

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VOLUMES, SOME DETERIORATION IN TERMS OF TRADE AND SHRINKAGE OF CURRENT ACCOUNT SURPLUS TO \$1.9 BILLION. SECRETARIAT NOTES THAT SWISS CENTRAL BANK INTERVENED IN FOREX MARKET DURING 1975 TO MODERATE FRANC APPRECIATION, AND EXPECTS THAT INTERVENTION WILL CONTINUE TO BE NECESSARY IN 1976 BECAUSE OF CONTINUING LARGE CURRENT ACCOUNT SURPLUS.

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4. POLICY: IN GENERAL, SECRETARIAT AGREES THAT PRESENT EXPANSIONARY STANCE OF FISCAL AND MONETARY POLICY ARE APPROPRIATE FOR 1976, BUT FEELS THAT FOLLOWING SPECIFIC POLICY QUESTIONS SHOULD BE EXPLORED DURING REVIEW:

(A) WHAT ARE THE LIKELY EFFECTS IN 1975 AND 1976 OF FISCAL STIMULATORY MEASURES (582 MILLION SWISS FRANCS) IMPLEMENTED IN JUNE 1975;

(B) WHAT WILL BE MAGNITUDE AND TIMING IN 1976 OF NEW STIMULATORY MEASURES (600 MILLION SWISS FRANCS) RECENTLY ANNOUNCED BY SWISS AUTHORITIES.

(C) HOW WILL TREASURY BORROWING REQUIREMENT

(2.8 BILLION SWISS FRANCS IN BOTH 1975 AND
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1976 BE FINANCED IN 1976; IS THERE LIABLE
TO BE A FINANCING PROBLEM OVER MEDIUM TERM
AND IF SO, WHAT MEASURES COULD BE TAKEN TO
INCREASE TAX REVENUES?

(D) SWISS FRANC WAS SUBJECT TO UPWARD PRESSURE
IN 1975; WHAT MONETARY POLICY MEASURES
COULD BE TAKEN IN 1976 TO PREVENT CONTINUED
PRESSURE IN 1976?

5. BASED ON ANALYSIS REFD0C, SECRETARIAT SUGGESTS THAT
EDRC ENDORSE FOLLOWING CONCLUSIONS:

(A) IN ORDER TO SUPPORT DOMESTIC ACTIVITY, IT
WOULD BE DESIRABLE FOR THE PROJECTS
SCHEDULED UNDER THE ADDITIONAL BUDGETS OF
THE CONFEDERATION AND THE LOCAL AUTHORITIES
AS WELL AS THOSE INCLUDED IN THE NEW
MEASURES RECENTLY ANNOUNCED BY THE AUTHOR-
ITIES, TO BE STARTED AS EARLY AS POSSIBLE
IN 1976 SO AS TO PRODUCE AN IMPACT ON THE
ECONOMY QUICKLY AND PREVENT THE DEVELOPMENT
OF FURTHER IDLE PRODUCTIVE CAPACITY;

(B) GIVEN THE FORESEEABLE SIZE OF THE PUBLIC
SECTOR'S BORROWING REQUIREMENT, MONETARY
POLICY SHOULD BE ADJUSTED IN SUCH A WAY AS TO
PERMIT SUFFICIENT LIQUIDITY CREATION AND TO
PREVENT A RISE IN INTEREST RATES WHICH WOULD
BE PREJUDICIAL TO INTERNAL EQUILIBRIUM. THIS
WOULD MAKE IT POSSIBLE TO CHECK THE SWISS
FRANC'S TENDENCY TO APPRECIATE.

6. COMMENT: (A) MISSION AGREES WITH SECRETARIAT
ANALYSIS THAT UPWARD PRESSURE ON SWISS FRANC WILL CON-
TINUE IN 1976. WE WOULD WANT TO STIMULATE DISCUSSION
ON EXTENT TO WHICH CONTINUED CENTRAL BANK INTERVENTION
TO MODERATE APPRECIATION IS APPROPRIATE, KEEPING IN
MIND CONSISTENCY OF SUCH INTERVENTION WITH POLICY OF
MAINTAINING MONETARY EASE DOMESTICALLY WHILE
FINANCING LARGE GOVERNMENT BORROWING REQUIREMENT PRO-
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JECTED BY SECRETARIAT FOR 1976. (B) SECRETARIAT NOTES
THAT SWISS ABILITY TO STIMULATE ECONOMY IS LIMITED BY
IMPORTANT ROLE OF CONSTRUCTION INDUSTRY IN WHICH LARGE
EXCESS SUPPLY OF HOUSING ALREADY EXISTS AND MEDIUM-TERM
DEMOGRAPHIC TRENDS POINT TO REDUCED FUTURE DEMAND.
JUNE 1975 STIMULATORY MEASURES WERE AIMED AT SUPPORT
OF CONSTRUCTION INDUSTRY. WHILE THIS IS UNDERSTANDABLE,
SHORT-RUN MEASURES OF THIS SORT COULD COMPOUND MEDIUM-
TERM STRUCTURAL PROBLEMS. MISSION PLANS TO EXPLORE THESE
QUESTIONS WITH SWISS.
TURNER

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